Fundamentals Level – Skills Module

Taxation (Pakistan)

Monday 1 December 2008

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 2–3.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F6 (PKN)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest rupee.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

A. Tax rates for individuals

where salary income exceeds 50% of taxable income for the tax year 2008.

Taxable income	Rate of tax
Up to Rs. 150,000*	0%
Rs. 150,001 – Rs. 200,000	0·25%
Rs. 200,001 – Rs. 250,000	0·50%
Rs. 250,001 – Rs. 300,000	0·75%
Rs. 300,001 – Rs. 350,000	1·50%
Rs. 350,001 – Rs. 400,000	2·50%
Rs. 400,001 – Rs. 500,000	3·50%
Rs. 500,001 – Rs. 600,000	4·50%
Rs. 600,001 – Rs. 700,000	6·00%
Rs. 700,001 – Rs. 850,000	7·50%
Rs. 850,001 – Rs. 950,000	9·00%
Rs. 950,001 – Rs. 1,050,000	10·00%
Rs. 1,050,001 – Rs. 1,200,000	11·00%
Rs. 1,200,001 – Rs. 1,500,000	12·50%
Rs. 1,500,001 – Rs. 1,700,000	14·00%
Rs. 1,700,001 – Rs. 2,000,000	15·00%
Rs. 2,000,001 – Rs. 3,150,000	16·00%
Rs. 3,150,001 – Rs. 3,700,000	17·50%
Rs. 3,700,001 – Rs. 4,450,000	18·50%
Rs. 4,450,001 – Rs. 8,400,000	19·00%
Rs. 8,400,001 and over	20·00%

* For a woman taxpayer where salary income exceeds 50% of taxable income for the tax year 2008, no tax is chargeable if taxable income does not exceed Rs. 200,000

B. Tax rates for individuals

to whom the rates given in A are not applicable.

Taxable income	Rate of tax
Up to Rs. 100,000	0%
Rs. 100,001 – Rs. 110,000	0·50%
Rs. 110,001 – Rs. 125,000	1·00%
Rs. 125,001 – Rs. 150,000	2·00%
Rs. 150,001 – Rs. 175,000	3·00%
Rs. 175,001 – Rs. 200,000	4·00%
Rs. 200,001 – Rs. 300,000	5·00%
Rs. 300,001 – Rs. 400,000	7·50%
Rs. 400,001 – Rs. 500,000	10·00%
Rs. 500,001 – Rs. 600,000	12·50%
Rs. 600,001 – Rs. 800,000	15·00%
Rs. 800,001 – Rs. 1,000,000	17·50%
Rs. 1,000,001 – Rs. 1,300,000	21·00%
Rs. 1,300,001 and over	25·00%

C. **Tax rates for companies**

Tax year	Public company	Private company	Small company
2008	35%	35%	20%

D. **Rates of advance collection or deduction of tax**

Collection of advance tax by the Collector of Customs on the import of goods	5% of the value of the goods

E. **Other tax rates**

On dividends received from a company	10% of the gross amount of the dividend
On income from property	5% of the rent chargeable to tax

F. **Capital allowances**

Depreciation		
Buildings (all types)	10%	of the tax written down value
Furniture and fittings	15%	of the tax written down value
Plant and machinery (not otherwise specified)	15%	of the tax written down value
Motor vehicles (all types)	15%	of the tax written down value
Computer hardware	30%	of the tax written down value
Initial allowance	50% of cost	

G. **Benchmark rate**

For determining the value of the perquisite on loans given to employees, the benchmark rate for the tax year 2008 is 10% per annum of the loan amount.

ALL FIVE questions are compulsory and MUST be attempted

1 Woodcrafts Pakistan Limited (WPL) is an industrial undertaking engaged in the business of manufacturing furniture using Swedish technology and designs. The following information is available for the accounting year ended 30 June 2008:

(1) WPL is a public company under the Companies Ordinance, 1984. 50% of its shares are held by Swedecrafts Company Inc (SCI), a company incorporated in Sweden. The Government of Sweden owns 51% of the shares in SCI. WPL is not listed on any stock exchange in Pakistan.

(2) WPL held 100% of the share capital in Stylecrafts (Private) Limited (Stylecrafts) on 1 July 2007. Stylecrafts is an industrial undertaking and is not engaged in the business of trading.

(3) WPL's accounting profit for the year ended 30 June 2008, after the transfer of Rs. 3,000,000 to dividend equalisation reserve account, was Rs. 9,000,000.

(4) Deductions charged in the accounts include:

		Rupees
(i)	Accounting depreciation.	750,000
(ii)	Donation to Poor Patients Hospital established in Karachi by the Provincial Government of Sindh.	600,000
(iii)	Air fare for the production manager's business visit to Sweden, paid in cash.	250,000
(iv)	Payment to a management consultant in the matter of increasing the company's share capital.	49,000
(v)	Payment to the Karachi Port Trust (KPT) being charges for not lifting imported goods from the docks within the time stipulated in the KPT rules.	50,000
(vi)	Legal costs incurred for the purpose of standing as a surety for the due performance of a supply contract entered into by Stylecrafts, a subsidiary company of WPL, with the Ministry of Industries, Government of Pakistan.	220,000

(5) Income shown in the accounts include:

		Rupees
(i)	Accounting profit on the sale of a motor car.	388,000
(ii)	Damages recovered against WPL's claim for loss of trading profits, from a supplier who failed to deliver a consignment of teak wood within the time stipulated in the supply contract.	1,000,000
(iii)	Unclaimed wages which had become time-barred. Out of the Rs. 650,000, Rs. 491,628 had been charged to tax by the Commissioner under the head 'Income for business' in the prior years as the amount had remained unpaid for three years from the end of the year the deduction was allowed.	650,000

(6) Fixed assets

(i) The tax written down values of the company's assets on 1 July 2007 were:

	Rupees
Plant and machinery	19,500,000
Buildings	9,660,000
Motor cars	5,090,000
Furniture	2,400,000
Computers hardware	3,800,000

(ii) During the year a motor car was sold for Rs. 900,000. The cost of the motor car was Rs. 1,500,000 but its cost was restricted to Rs. 1,000,000 for the purposes of claiming tax depreciation. The tax written down value of the car at the time of its sale was Rs. 510,000.

(iii) On 1 December 2007, the following assets were purchased:
- one new motor car for Rs. 2,000,000
- ten new personal computers for Rs. 760,000

(iv) During the year Rs. 10,800,000 was expended on the construction of a residential building for workers. The Rs. 10,800,000 included Rs. 2,000,000 for the cost of land. The workers occupied the building on 1 May 2008.

(7) Other information

(i) Rs. 11,950,000 was expended on the in-house development of a computer software for designing standardised office furniture. The software was used for the first time by WPL in its business chargeable to tax on 1 January 2008. Considering the fast changing trends in furniture design it was not possible to estimate the normal working life of the software. It was however decided by the management that the Rs. 11,950,000 should be treated as deferred revenue expenditure and written off equally over five years. Accordingly Rs. 2,390,000 (1/5 of Rs. 11,950,000) has been charged to cost of sales for the year ended 30 June 2008.

(ii) Sundry creditors include Rs. 700,000 being a provision made on 30 June 2008 for gratuities payable to employees on their retirement under a gratuity scheme approved by the then Central Board of Revenue. The Rs. 700,000 has been charged as an expense under the account head of salaries and wages.

(iii) On 3 November 2007, WPL sold 26% out of its 100% shareholding in Stylecrafts (subsidiary company) for a gain of Rs. 180,000. The shares sold had been held for more than one year.

(iv) Stylecrafts furnished its return of income for the tax year 2008 to the tax department under the self assessment scheme, on 1 December 2008, declaring a tax loss of Rs. 875,000 for its accounting year ended 30 June 2008. The Chief Financial Officer of WPL wants Stylecrafts to surrender this loss of Rs. 875,000 in favour of WPL, so that WPL can set off the Rs. 875,000 against its taxable income for the tax year 2008.

(v) Advance tax paid by WPL for the tax year 2008 in quarterly instalments was Rs. 1,120,000.

Required:

(a) State, giving reasons, whether or not Woodcrafts Pakistan Limited is a public company for tax purposes.
(2 marks)

(b) Compute the taxable income of Woodcrafts Pakistan Limited for the tax year 2008 under the appropriate heads of income, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed.

Note: the reasons/explanations for the items not listed in the computation of taxable income should be shown separately from the other reasons/explanations. (25 marks)

(c) Calculate the tax payable by or refundable to Woodcrafts Pakistan Limited for the tax year 2008.
(3 marks)

(30 marks)

2 The following information is provided to you by Mr Abdullah

(1) Abdullah is a citizen of Pakistan and until 30 June 2007, he was an employee of the Karachi branch of ABC Inc, a company incorporated in the United States. On 28 June 2007, Abdullah opted for early retirement under a voluntary retirement scheme floated by ABC Inc. His resignation was accepted on the same day and ABC Inc., gave instructions to their bank to transfer, before 30 June 2007, Rs. 1,850,000 into the bank account of Abdullah. The Rs. 1,850,000 is made up of the following:

	Rupees
– Salary for the month of June 2007	300,000
– Gratuity under a gratuity scheme of ABC Inc. The scheme was not approved by the Federal Board of Revenue and was applicable only to the employees in the management cadre.	750,000
– Compensation for redundancy of employment	800,000
	1,850,000

The Rs. 1,850,000 was credited to Abdullah's bank account on Monday 2 July 2007 as 30 June 2007 was a bank holiday.

On retirement Abdullah was also entitled to a monthly pension of Rs. 20,000 payable on the first working day of each month commencing from the month of July 2007.

(2) On 30 June 2007, Rs. 100,000 was payable by Abdullah to ABC Inc against a loan taken by him. On 16 July 2007 Abdullah informed ABC Inc that Rs. 70,000 was due to him as salary in lieu of unused privileged leave. He required ABC Inc to apply the Rs. 70,000 toward part-repayment of the loan. ABC Inc did not pay the Rs. 70,000 to Abdullah but on 16 July 2007 applied the Rs. 70,000 against the outstanding loan amount of Rs. 100,000. On 30 June 2008, the balance amount of Rs. 30,000 outstanding against the loan, was waived by ABC Inc.

(3) On 2 July 2007, Abdullah imported 5,000 units of pressure cookers. The entire consignment was sold to Kitchen Appliances, a sole proprietorship concern. Abdullah wound up this activity of imports on 30 September 2007 after making a nominal profit of Rs. 7,500. The summarised profit and loss account for that period is as follows:

	Rupees	Rupees
Sales		10,000,000
Cost of sales		
– Cost of the 5,000 units	8,850,000	
– Tax collected by the collector of customs on the value of the imported goods	442,500	
– Damages paid to Kitchen Appliances against a claim for defective cookers	700,000	9,992,500
Net profit		7,500

(4) On 1 August 2007, when Abdullah was no longer an employee of ABC Inc, he was allowed to participate in the ABC Employee Share Scheme (Scheme). The custodian of the Scheme granted Abdullah the right to acquire 1,000 shares in ABC Inc at the exercise price of US$ 10 per share. There was no payment to be made for the right to acquire the shares. The price of the shares in ABC Inc quoted on the New York Stock Exchange on 1 August 2007 was US$ 12 per share and the value of one right on that date was estimated by the custodian to be US $2.

(5) On 1 August 2007, Abdullah was offered employment as the finance manager of PQR Ltd Karachi. As an inducement for Abdullah's agreement to enter into an employment relationship commencing from 1 September 2007, PQR Ltd proposed to give Abdullah a loan of Rs. 1,000,000 free of profit. On Abdullah's agreement to the proposal, he received the Rs. 1,000,000 from PQR Ltd on 1 August 2007 at which time Abdullah was not an employee of PQR Ltd. The loan was repayable in 10 equal yearly instalments but Abdullah repaid the full amount of the loan on 30 April 2008.

(6) Abdullah commenced employment with PQR Ltd on 1 September 2007. His terms of employment provided for the following:

(i) A basic salary of Rs. 300,000 per month.

(ii) Monthly cash allowances of:
– 25% of basic salary each for utilities and medical;
– 45% of basic salary for housing.

(iii) One return business class air-fare for Abdullah's personal travel to London in a year.

(iv) A company maintained motor car for his business and private use.

(v) Abdullah is not entitled to free medical treatment or hospitalisation or to the reimbursement of such charges.

(7) Other information submitted by Abdullah

(i) Abdullah accepted the benefit of the return air passage to London on 2 April 2008 which cost PQR Ltd Rs. 217,500.

(ii) In order to provide the benefit of a company maintained motor car to Abdullah, a new motor car was purchased by PQR Ltd on 1 October 2007, for Rs. 1,500,000.

(iii) Abdullah received a special monthly allowance of Rs. 20,000 from PQR Ltd to meet entertainment expenses wholly and necessarily to be incurred in the performance of his duties as a finance manager.

(iv) Tax deducted at source by PQR Ltd from Abdullah's salary for the relevant tax year was Rs. 1,100,000.

(v) On 1 June 2008 Abdullah resigned from PQR Ltd and left Pakistan for Dubai on the same day and remained in Dubai until 30 June 2008. He commenced employment with Lotus Associates, Dubai on 1 June 2008 at a consolidated salary of US$ 10,000 per month. He was also provided with residential accommodation which cost Lotus Associates US$ 4,000 per month.

(vi) On 1 May 2008 Abdullah disposed of the right to purchase the 1,000 shares in ABC Inc for Rs. 215,000.

(vii) On 1 May 2008, by a notice in writing to the Commissioner, Abdullah had elected to be taxed on the amount of the compensation for redundancy received from ABC Inc at the average rate of tax paid by him on his total income for the preceding three tax years. This tax rate worked out at 15%.

(viii) Abdullah is the owner of a building in the Defence Housing Society. On 1 September 2007, he rented the building to Mr X for Rs. 76,000 a month, which amount includes Rs. 10,000 for providing a security guard for the building. The following expenses were incurred by Abdullah on the building:

	Rupees
Repairs and renovation	20,000
Ground rent	3,000
Insurance	6,000
	29,000

Abdullah paid Rs. 5,000 a month as salary to the security guard.

(ix) Abdullah rented a factory building in the Korangi Industrial Estate on 1 July 2006 and paid three years rent in advance at the rate of Rs. 650,000 per annum. On 1 July 2007, Mr Bee wanted to sub-lease the building from Abdullah at an annual rental of Rs. 2,000,000. As an inducement for Abdullah's agreement to enter into a sub-lease arrangement for two years, Bee proposed to pay Abdullah a deposit of Rs. 3,000,000 which would not be adjustable against the rent. On Abdullah's agreement to the proposal, Bee paid Abdullah on 2 July 2007:
– Rs. 4,000,000 as rent in advance for two years; and
– Rs. 3,000,000 as a deposit which was not adjustable against the rent.

(x) On 2 July 2007 Abdullah invested Rs. 500,000 in the purchase of new shares in Classic Cars Ltd, a public company listed on the Lahore Stock Exchange. Classic Cars Ltd had offered the new shares to the public and Abdullah was an original allottee of the shares.

Required

(a) Compute the taxable income of Mr Abdullah under the appropriate heads of income for the tax year 2008, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income for each of the items listed.

Note: the reasons/explanations for the items not included in the computation of income should be shown separately from the other reasons/explanations. (20 marks)

(b) Calculate the tax payable by or refundable to Mr Abdullah for the tax year 2008. (5 marks)

(25 marks)

This is a blank page.
Question 3 begins on page 10.

3 **(a)** Medico Pakistan Ltd (MPL) is a company incorporated in Pakistan under the Companies Ordinance, 1984 and is engaged in the business of manufacturing pharmaceuticals. 49% of the shares in MPL are owned by Chin Inc (CI), a company incorporated in a country which has no tax treaty with Pakistan for the avoidance of double taxation. CI's only income in Pakistan is from the dividends received from MPL. On 30 June 2008, CI disposed of its 49% share holding in MPL to a tax resident of the United Kingdom (UK). The sale transaction was completed in the UK and the sale consideration was also received by CI in the UK. The sale of the shares in MPL resulted in a gain of US$ 75,000 to CI.

CI is of the view that the US$ 75,000 is not chargeable to tax in Pakistan since the entire transaction of the sale was completed outside Pakistan and the sale consideration was also received outside Pakistan.

Required:

State, giving reasons, whether or not the view of Chin Inc is correct. (3 marks)

(b) Mr Prospector (P), a non-resident for Pakistan tax purposes, holds 50% of the shares in Black Gold Inc (BGI), a company incorporated in a country which has no tax treaty with Pakistan for the avoidance of double taxation. BGI is a non-resident company for Pakistan tax purposes. BGI entered into an agreement with the Government of Pakistan (GOP) under which BGI was given the right to explore for and exploit crude oil and natural gas in an area of Pakistan. This right to explore for and exploit crude oil and gas is the principal asset of BGI in Pakistan. The profit and loss share in the venture of exploration and production of oil and gas was 51% to GOP and 49% to BGI. BGI commenced operations in Pakistan as a branch on 1 January 2007.

On 30 June 2008, P disposed of his entire share holding in BGI to Mr Q, a tax resident of the United Kingdom (UK). The sale transaction was completed in the UK and the sale consideration was also received by P in the UK. The sale of the shares in BGI resulted in a gain of US$ 2,500,000 to P.

P is of the view that since he was a non-resident in the tax year 2008 and the gain of US$ 2,500,000 arose from the sale of the shares in BGI, which is a non-resident company for Pakistan tax purposes, the US$ 2,500,000 is not chargeable to tax in Pakistan.

Required:

State, giving reasons, whether or not the view of Mr Prospector is correct. (3 marks)

(c) The following information is furnished to you by Mr Vakil, the executor to the estate of the late Mrs Moneybags (M).

(1) M died on 1 June 2008

(2) On the basis of M's return of income for the tax year 2007 (accounting year ended 30 June 2007) furnished to the tax department under the self-assessment scheme, the position of M's unadjusted losses was as follows:

- Rs. 768,640 loss for the tax year 2007 on account of forward trading in raw cotton on the cotton exchange. The forward contract was settled otherwise than by actual delivery of cotton.
- Rs. 560,650 capital loss sustained under the head 'Capital gains' which is made up as follows:

Accounting year ended on:	**Rupees**
30 June 2002	215,650
30 June 2001	345,000
	560,650

(3) At the time of M's death, she was survived by her three children whose details are as follows:

(i) Ginnie, her daughter, is an author. She left Pakistan for London on 30 December 2007 and has been living in London since then.

(ii) Peechu, her son, is an artist living in Paris. During the year ended 30 June 2008, he came to Pakistan for the Eid holidays on 21 March 2008 for a week.

(iii) Roshi, her daughter, has always been resident in Pakistan.

(4) On 20 June 2008, Mr Vakil, in accordance with the last will and testament of M, transferred the following assets of M to the beneficiaries:

(i) To Roshi:
- 1,000 shares in Zee (Private) Ltd which M had acquired on 2 July 2007 for Rs. 20,000.
- A residential house in Shaheen Housing Society, which had been inherited by M in 1970 and was then valued at Rs. 11,500,000.

(ii) To Ginnie:
- The rupee equivalent of US$ 40,000 which was kept by M in a safe deposit vault. The US$ 40,000 was converted into Pakistan rupees through an authorised dealer in foreign exchange at the rate of US$ 1 = Rs.64. The US$ 40,000 had been purchased by M in 1985 for Rs. 800,000.
- Rs. 3,419,017 being the credit balance in M's bank account.

(iii) To Peechu:
- A rare Chinese manuscript of the Sung Dynasty which had been purchased by M in 1950 for Rs. 7,000,000. The manuscript was considered by M to be her own personal asset.
- 10,000 shares in Moneybags Investment Ltd (MIL). The shares were inherited by M from her father who, as the founder member of MIL, had acquired the shares for Rs. 10 per share. The break-up value of one share in MIL on 20 June 2008, as determined by a firm of Chartered Accountants, was Rs. 120.
- An original painting of the early Italian period, which had been purchased by M in 1945 for Rs. 7,500,000. The painting was considered by M to be her own personal asset.

(5) Other information

(i) J B Boots Associates, a firm of surveyors and valuers was appointed by Mr Vakil to determine the fair market value, as on 20 June 2008, of the Chinese manuscript, the painting of the Italian period, the residential house and the 1,000 shares in Zee (Private) Ltd.

J B Boots reported that:
- the Chinese manuscript was valued at Rs. 1,000,000. The condition of the manuscript had deteriorated due to careless storage;
- the painting was valued at Rs. 25,000,000;
- the residential house was valued at Rs. 30,000,000; and
- the break-up value of one share in Zee (Private) Ltd was Rs. 5.

(ii) M had retired from the employment of Exotic Sea Foods Inc (ESF) on 31 December 2006. M was hospitalised for a month prior to her death. Despite M's terms of employment not providing for any medical benefits after retirement, the hospital bill of Rs. 1,174,300 was paid by ESF directly to the hospital on 28 May 2008.

(iii) On 1 May 2008, M had donated Rs. 2,000,000 to a hospital in Karachi run by the Federal Government.

Required:

(i) Compute the taxable income of the late Mrs Moneybags under the appropriate heads of income for the tax year 2008, giving clear reasons/explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed.

Note: the reasons/explanations for the items not included in the computation of income should be shown separately from the other reasons/explanations. (12 marks)

(ii) Calculate the tax payable by or refundable to Mrs Moneybags for the tax year 2008. (2 marks)

(20 marks)

4 Mr Chaiwalla, a resident for Pakistan tax purposes, is engaged in the business of operating a number of café's in Karachi under the name of Doodpati Chai. The assessment of Chaiwalla for the tax year 2007 (accounting year ended 30 June 2007) was selected for audit under section 177 of the Income Tax Ordinance, 2001.

(1) On completion of the audit the Commissioner issued a notice to Chaiwalla requiring him to give reasons, within seven days of the receipt of the notice, why the assessment for the tax year 2007 should not be amended to:

(i) Disallow Rs. 150,000 paid to Doodpati Inc Bahamas, for the use of the brand name 'Doodpati', since no tax was deducted from the amount remitted to Doodpati Inc.

(ii) Disallow Rs. 50,000 paid to Mr Consultant for suggesting cost-cutting measures in the café's, since no tax was deducted from the amount paid to Mr Consultant.

(iii) Treat Rs. 40,000 received from Ali Canteen Stores Lahore as income chargeable to tax. The Rs. 40,000 received had been credited to Chaiwalla's capital account.

(iv) Treat Rs. 36,000 received from Orchids Farms Ltd as income chargeable to tax. The Rs. 36,000 received had been credited to Chaiwalla's capital account.

(v) Disallow Rs. 7,500 salary paid in cash to Mr A, a temporary worker employed for the month of May 2007.

(2) Chaiwalla is not in agreement with the Commissioner's proposal to amend the assessment. As required in the notice issued by the Commissioner, Chaiwalla has submitted his objections to the proposed amendments in writing together with the following reasons and explanations:

(i) **Payment of Rs. 150,000 to Doodpati Inc on account of royalty**

No tax was required to be deducted from the payment of Rs. 150,000 made to Doodpati Inc (DI) since:

- DI had no permanent establishment in Pakistan in the tax year 2007 and consequently the royalty income of DI is not chargeable to tax in Pakistan; and
- DI is a company incorporated in the Bahamas where no income tax is payable.

(ii) **Payment of Rs. 50,000 to Mr Consultant**

The Rs. 50,000 was a payment by way of an advance and therefore tax was not deducted from the payment. The total amount payable to Mr Consultant for the assignment is Rs. 120,000 and when the balance amount of Rs. 70,000 is paid, tax would be deducted at the prescribed rate on the total amount of Rs. 120,000.

(iii) **Rs. 40,000 received from Ali Canteen Stores Lahore**

The amount received from Ali Canteen Stores Lahore relates to the business of a coffee house previously run by Chaiwalla in Lahore. The coffee house business ceased to exist on 31 December 2002. As on 31 December 2002, Ali Canteen Stores Lahore owed Chaiwalla Rs. 40,000 in respect of the sale of coffee beans. The Rs. 40,000 had not been recognised as the taxable income of Chaiwalla, since the system of accounting was on the cash basis.

The receipt of Rs. 40,000 is a capital receipt and is not chargeable to tax since:

- it is not a profit or gain of a business carried on by Chaiwalla at any time during the tax year 2007;
- it is not traceable to any source of income in the tax year 2007; and
- the receipt relates to the coffee house business which had ceased business on 31 December 2002 i.e. before the commencement of the tax year 2007.

(iv) **Rs. 36,000 received from Orchids Farms Ltd**

This amount represents a dividend received from Orchids Farms Ltd (OFL). OFL's income is derived wholly from agriculture and is therefore exempt from tax. The dividend of Rs. 36,000 being paid from an exempt income is therefore not chargeable to tax.

(v) **Salary of Rs. 7,500 paid in cash**

Rs. 7,500 was paid in cash to A, a temporary worker, as A did not have a bank account.

Required:

State giving reasons, whether or not in each case, the amendments proposed by the Commissioner is or is not in accordance with the provisions of the tax statute.

Note: the allocation of marks is as follows: issues (i), (ii) and (iv), 3 marks each; issue (iii) 4 marks and issue (v) 2 marks.

(15 marks)

5 **(a)** Barq Ro (Pakistan) Ltd (BRPL), a registered person under the Sales Tax Act, 1990, is engaged in the manufacture and sale of insulated cables. BRPL's financial year is the year ended on 30 June annually. The management of BRPL decided to start a new unit for the manufacture of underground cables that would require specialised machinery. The machinery was purchased on 1 May 2008 and the new unit commenced production on 4 May 2008.

The business transactions of BRPL for the month of May 2008 were as follows:

	Rupees
Payment for purchase of raw materials	7,448,850
Payment for advertisements	850,000
Payment for the purchase of machinery for the new unit	5,395,500
Sale of taxable goods in Pakistan	6,535,000
Export of cables to Tanzania	5,790,000

Notes:
(1) All payments are stated inclusive of sales tax.
(2) The figures for the sale of taxable goods and export are stated exclusive of sales tax.

Required:

Calculate the sales tax payable by or refundable to Barq Ro (Pakistan) Ltd for the month of May 2008 giving clear explanations for the treatment accorded to the following items in determining the amount of input tax on:

– **the purchase of raw materials and advertisements; and**
– **the purchase of machinery for the new manufacturing unit.** (7 marks)

(b) Mr Yousha, a registered person under the Sales Tax Act, 1990, is carrying on business in the name of Yousha Associates. Yousha is informed by his chief accountant that a credit note has to be issued to a debtor in respect of an invoice issued on 30 June 2008. The chief accountant intends to issue the credit note in the month of January 2009.

Required:

State, giving reasons, whether or not you are in agreement with the chief accountant's proposal to issue the credit note in the month of January 2009. (3 marks)

(10 marks)

End of Question Paper